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FEDERAL ESTATE TAX GONE TODAY!!! BACK TOMORROW???

The ultimate goal of the estate planning process can be simply stated: developing a plan which insures that a client's assets are transferred to the designated beneficiaries in the most efficient fashion with the least amount of reduction in the value of the assets as a result of taxes and probate expenses.

Clients have a clear picture of who they wish to receive the benefit of their life efforts. Generally, they wish to have their assets distributed to their loved ones and charities that they have a passion for. Fulfilling these intentions is the primary goal of the estate planning process. These intentions can generally be stated on a page or two. Despite the client's simple instructions for accomplishing this primary goal, estate planning documents have become more and more burdensome to accomplish the individual's secondary goal, minimizing the burden imposed by estate taxes and the costs of probate administration.

The estate tax structure represents the largest single expense which can shrink a decedent's assets and thwart the client's desire to transfer assets to beneficiaries. The estate tax is the government's version of playing "Robin Hood": if you are too "wealthy", the government is going to "steal" some of your wealth and redistribute it according to their desires.

The definition of "wealthy" is an amount of money ("exemption amount") artificially established by the Internal Revenue Code. This amount has changed over the years being as low as \$60,000.00 in 1954 increased to \$600,000.00 in 1986, increasing in 2002 and 2003 to \$1,000,000.00 and growing to \$3,500,000.00 for decedents dying in 2009. To the extent that the size of the decedent's estate is in excess of this definition of "wealthy", a tax as high as fifty-five percent (55%) of the excess could be extracted, hence, why we feel the estate tax is "stealing from the rich".

Because of the huge impact which the estate tax has had on client's estates, planning for estate tax savings has become the proverbial "tail wagging the dog" in estate planning and in many cases becoming the primary goal. Effective for decedent's dying after January 1, 2010, a recent change in the tax law may mean that estate taxes are no longer an issue. Although this may seem like good news, it is a double edged sword which can have some major consequences on the primary goal of one's estate plan which requires immediate attention.

Estate Tax Changes

Prior to 2010, the Internal Revenue Code imposed a tax on the estates of deceased persons if the value of their assets exceeded the then current exemption amount of \$3.5 million. However, pursuant to the Economic Growth and Tax Relief Reconciliation Act ("EGTRRA") signed by President Bush in 2001, the estate tax is temporarily suspended for decedents dying in 2010 coming back into effect for decedents dying in 2011 and thereafter with an exemption amount of \$1,000,000.00.

Generation Skipping Transfer Tax

Like the Estate Tax, EGTRRA temporarily suspends the Generation Skipping Tax for decedents dying in 2010 coming back into effect for decedents dying in 2011 and thereafter with an exemption amount of \$1,000,000.00.

Gift Tax Changes

Despite the temporary suspension of both the Estate and Generation Skipping Transfer taxes, the Gift Tax will remain in force with a reduced marginal rate of 35%.

Capital Gains Tax Changes

Another change relates to the income tax basis of assets inherited from Estates. Income tax basis is the value from which gain or loss on assets sold is measured. Under prior law, the income tax basis of an asset was "stepped-up" to its fair market value when the decedent passes away. However, with the suspension of the Estate Tax, this "step-up" in basis will no longer occur at the owner's death. The deceased owner's income tax basis will now "carry-over" to the persons who inherit the assets. Under prior law, if a person died owning a share of stock with a basis of \$50 and a value of \$100, then his beneficiaries would inherit that share of stock and take an income tax basis of \$100. Under 2010 law, those beneficiaries would only take a \$50 dollar "carry-over" basis in that share of stock.

Will Congress Allow the Suspension of the Tax to Continue?

Both houses of Congress have resolved to "fix the problem" of allowing tax revenues from the Estate Tax and Generation Skipping Tax to disappear from the government's budget and will most likely attempt to make any change in the law

retroactive to January 1, 2010. If the changes are made retroactive, that will add additional uncertainty because those changes will be subject to Constitutional challenge. It is not certain how Congress will act, however it seems relatively certain that the Estate Tax will be return in some form, especially given the current Administration and Congress' need for revenue.

What do Clients Need to Do?

Review your Estate Planning Documents: One of the basic tools which have traditionally been effective in reducing the estate tax shrinkage and avoiding the administrative expenses of probate administration has been the use of a living trust. Traditionally, the trust would contain "AB" provisions which provided that upon the death of the first spouse, an amount of assets equal to the definition of "wealthy" (exemption amount) would be allocated to a separate trust, generally referred to as the "B Trust", "Family Trust or Children's Trust. The other assets in excess of such definition of "wealthy" (exemption amount) would be allocated to another separate trust, commonly known as the "A trust" or "Marital Trust". In many instances, the beneficiaries of these two trusts could be different (such in the case of a second marriage) and also the Trustees who would be in charge of managing the assets subsequent to the first death could be different. As a result of at least temporary suspension of the Estate Tax, such instruments could cause the entirety of the decedent's estate to be allocated to the B trust or Children's Trust to the exclusion of allocation of assets to the Marital Trust. This result could be contrary to the client's primary goal as to who should be the beneficiaries to receive the ultimate distribution as the beneficiaries of such individual trusts could be different. In addition, to the extent that the surviving spouse is not the trustee of the B Trust or Children's Trust, the surviving spouse could be deprived of his or her right to be involved in the decision-making process involving the entirety of the decedent's assets. It is important that you review your Estate Planning Documents to make sure that they still follow your wishes regarding the ultimate distribution of your property to your beneficiaries.

Maintain Income Tax Basis Records: The elimination of a "step-up" in income tax basis at the date of death will create an administrative nightmare that could cost your heirs substantial income tax dollars. As a result, you should also consider gathering information on the basis of your assets so those amounts will be known to the beneficiaries of your Estates.

Consider Planning Opportunities: The suspension of the Estate Tax and the Generation Skipping Tax could provide unique opportunities to pass wealth to the next generation.

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